



**EUROPEAN
DEPARTMENT**

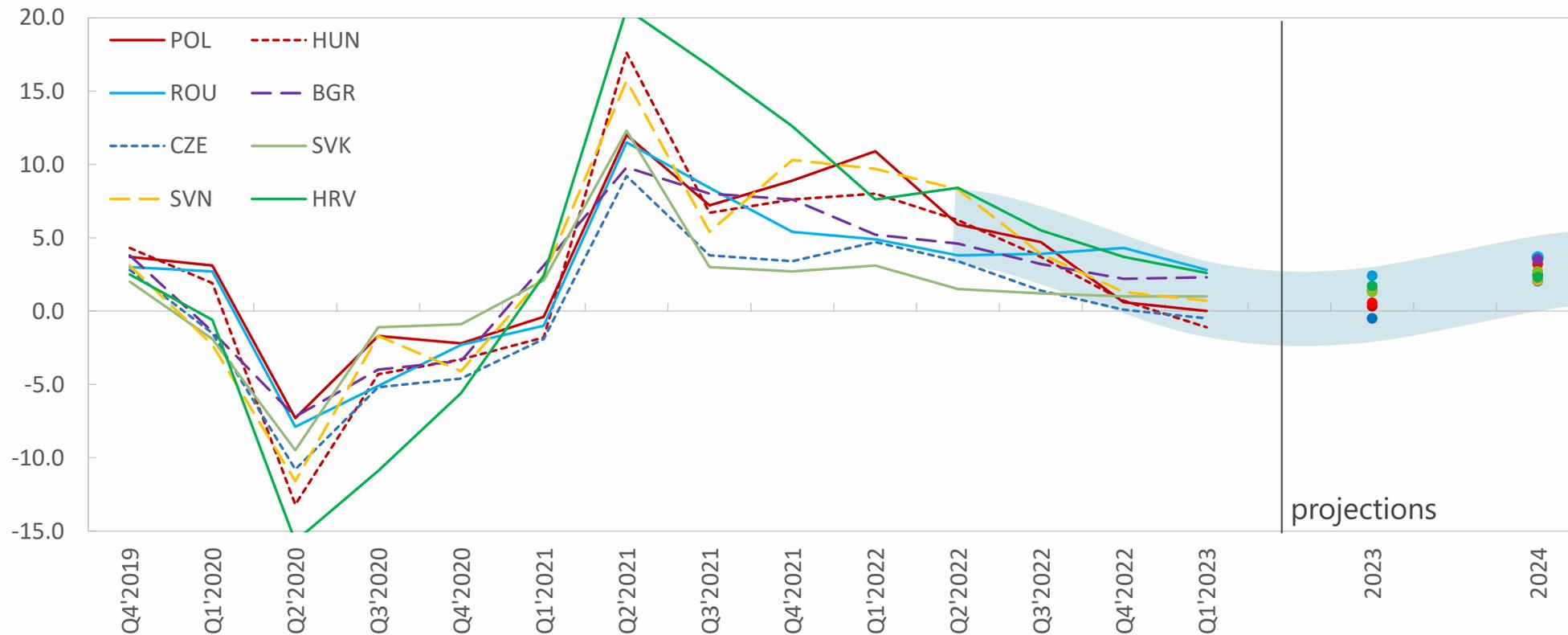
Europe in a Fragmented World

FRANKFURT, JULY 17, 2023

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European Department

Soft landing expected, followed by a mild recovery.

CESEE Real GDP growth 2019-2024
(percent y/y)

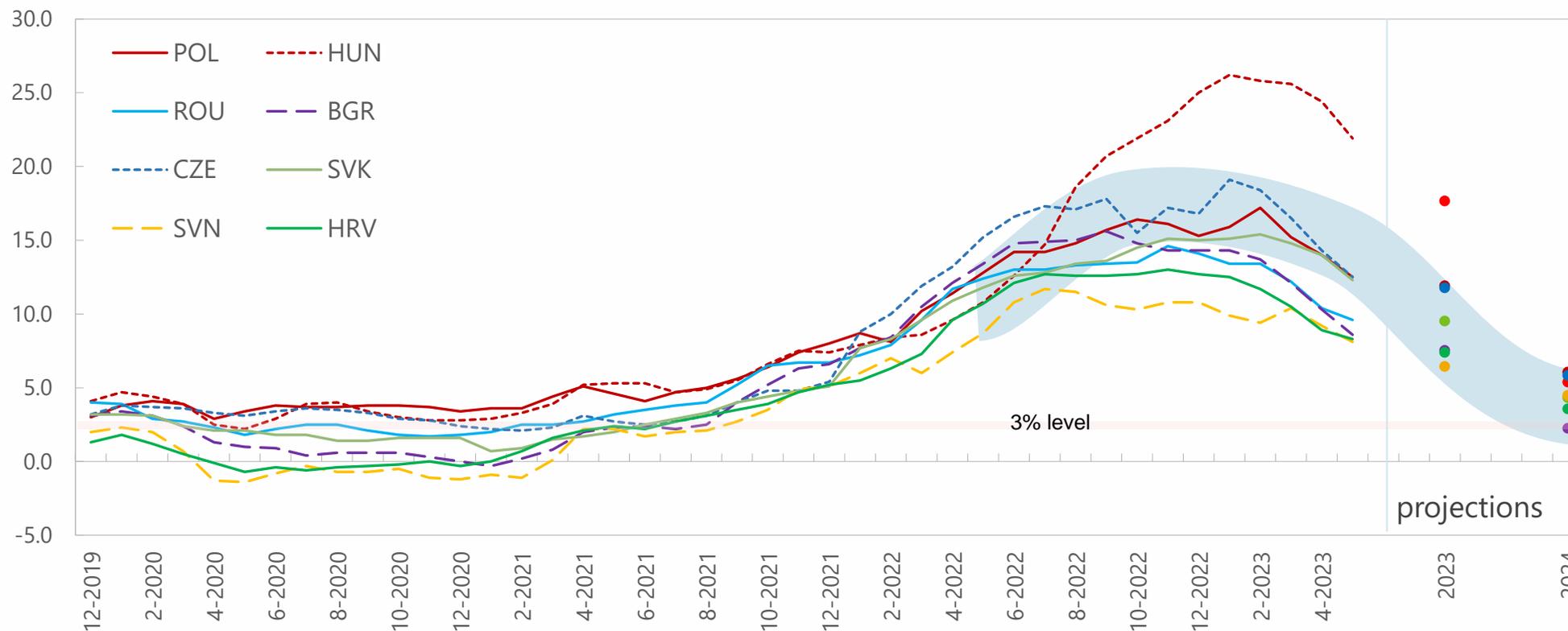


Source: Haver Analytics; Eurostat; and IMF WEO projections.

Inflation pushed to worrying levels....

CESEE HICP Inflation 2019-2024

(percent y/y)

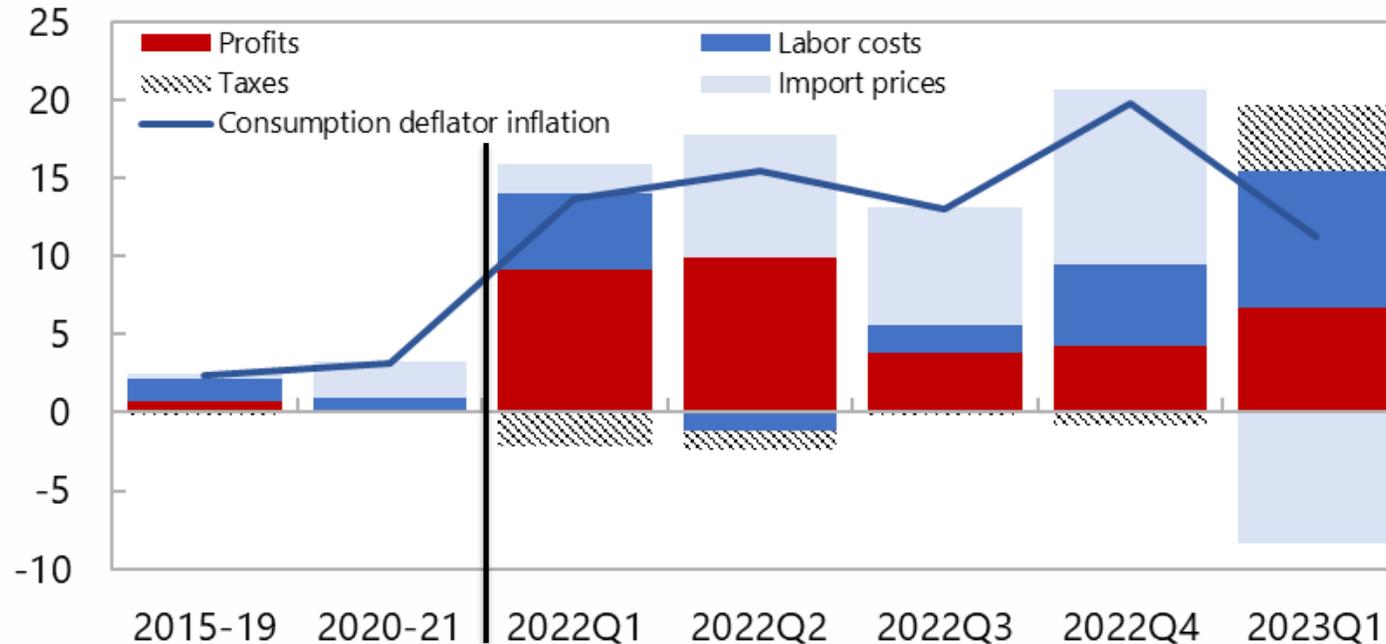


Source: Haver Analytics; Eurostat; and IMF WEO projections.

...global factors, profits, and labor costs all contributed.

CESEE: Consumption Deflator Inflation Decomposition

(Percentage points, qoq saar)

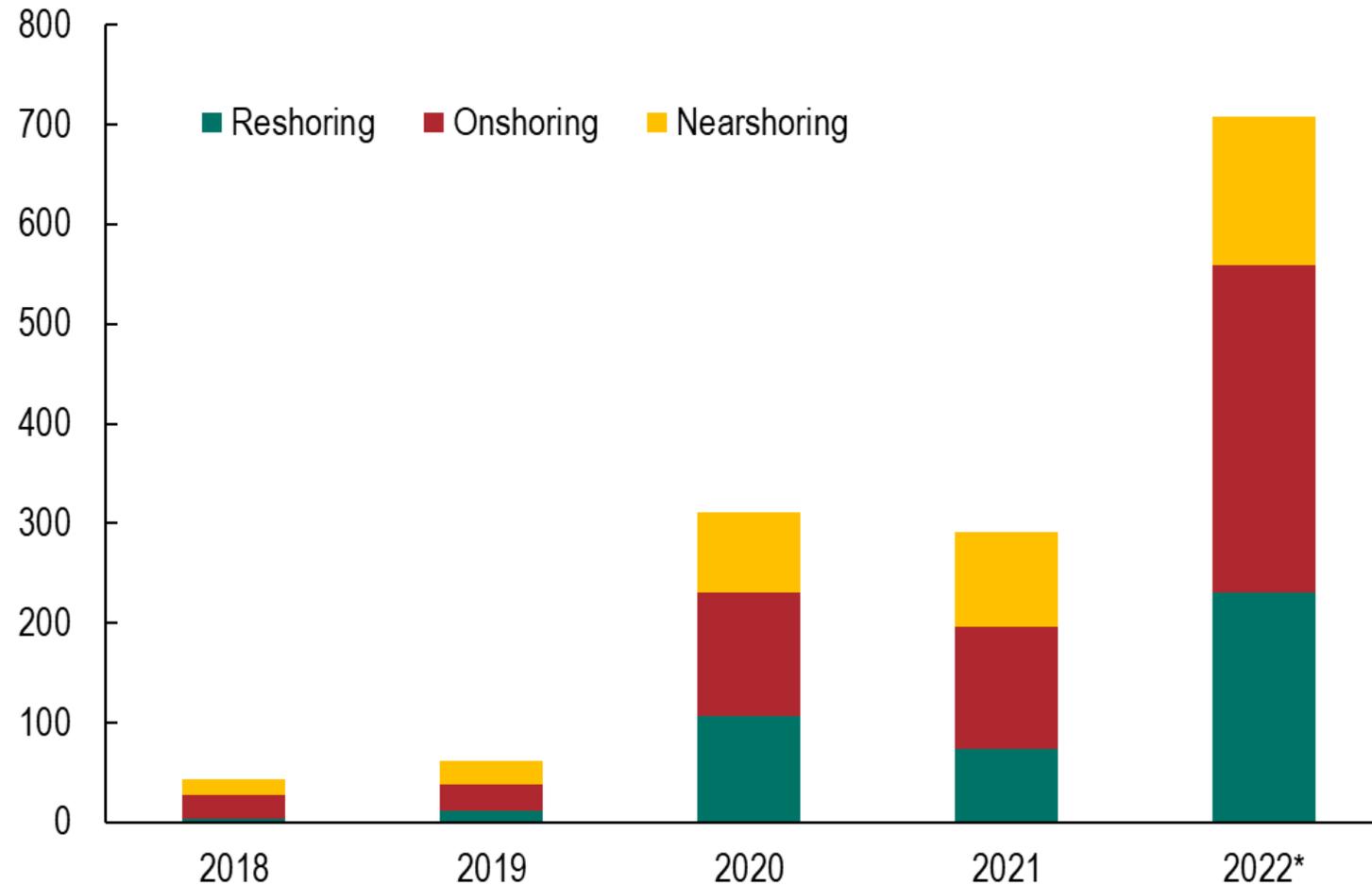


Sources: Eurostat, OECD, IMF staff calculations.

Note: Country samples include BGR, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK and SVN from 2015 to 2022. BGR and ROU are excluded from the aggregation in 2023Q1 due to missing decomposition components.

Fragmentation will remain a disruptive force

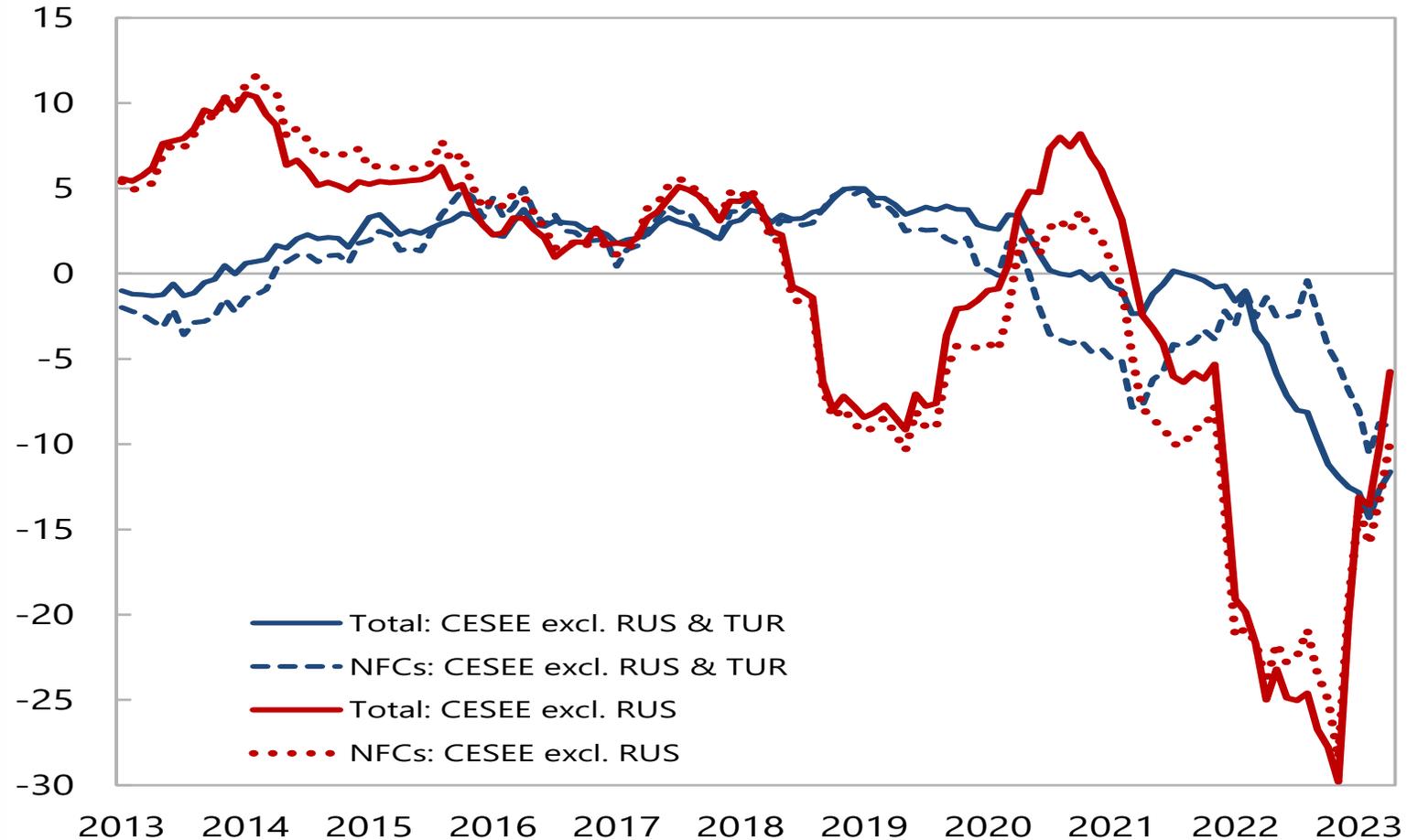
Frequency of Mentions of Key terms in Corporate Presentations (Numbers)



This makes disinflation a first order policy priority.

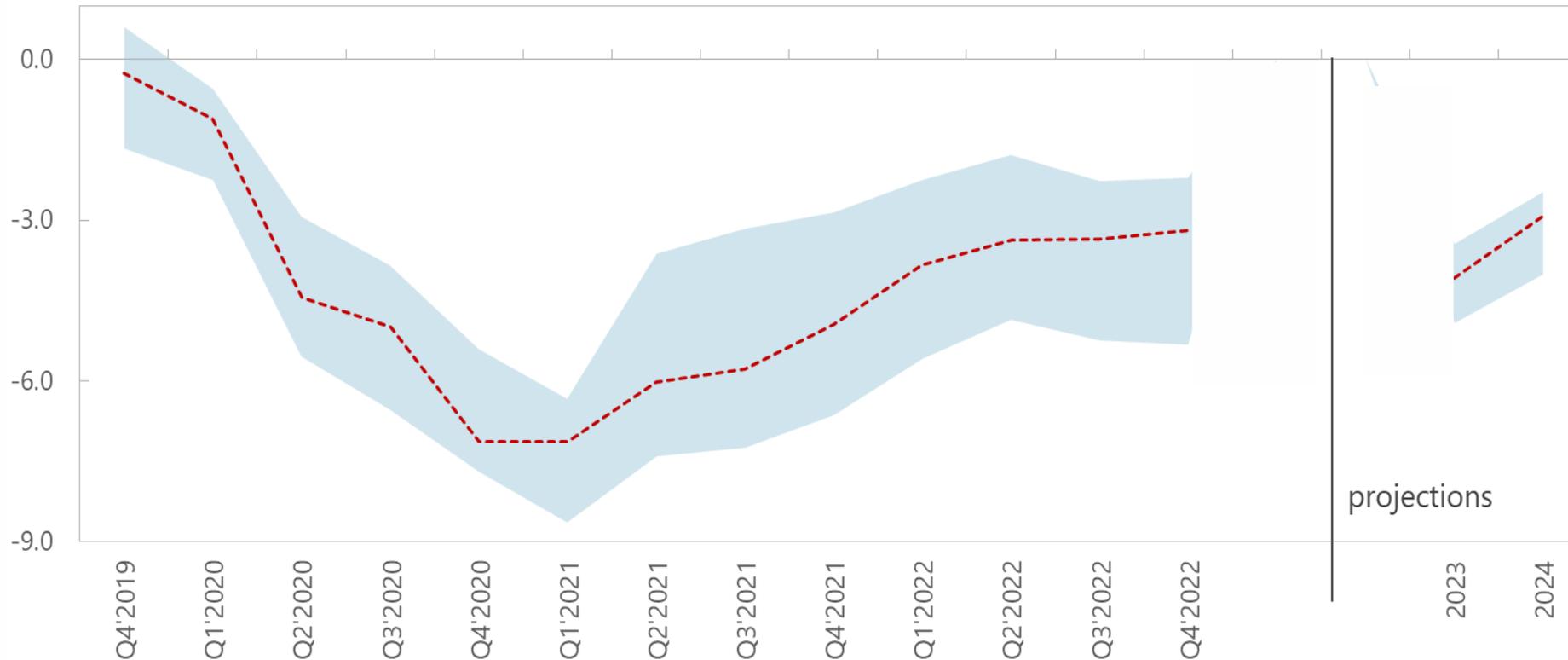
CESEE: Credit to Private Sector, 2013–2023

(Percent change, year-over-year, real, exchange-rate adjusted, GDP-weighted)



Fiscal policy should help more with disinflation

CESEE General Government Balance
(percent of GDP, 4q-rolling average)

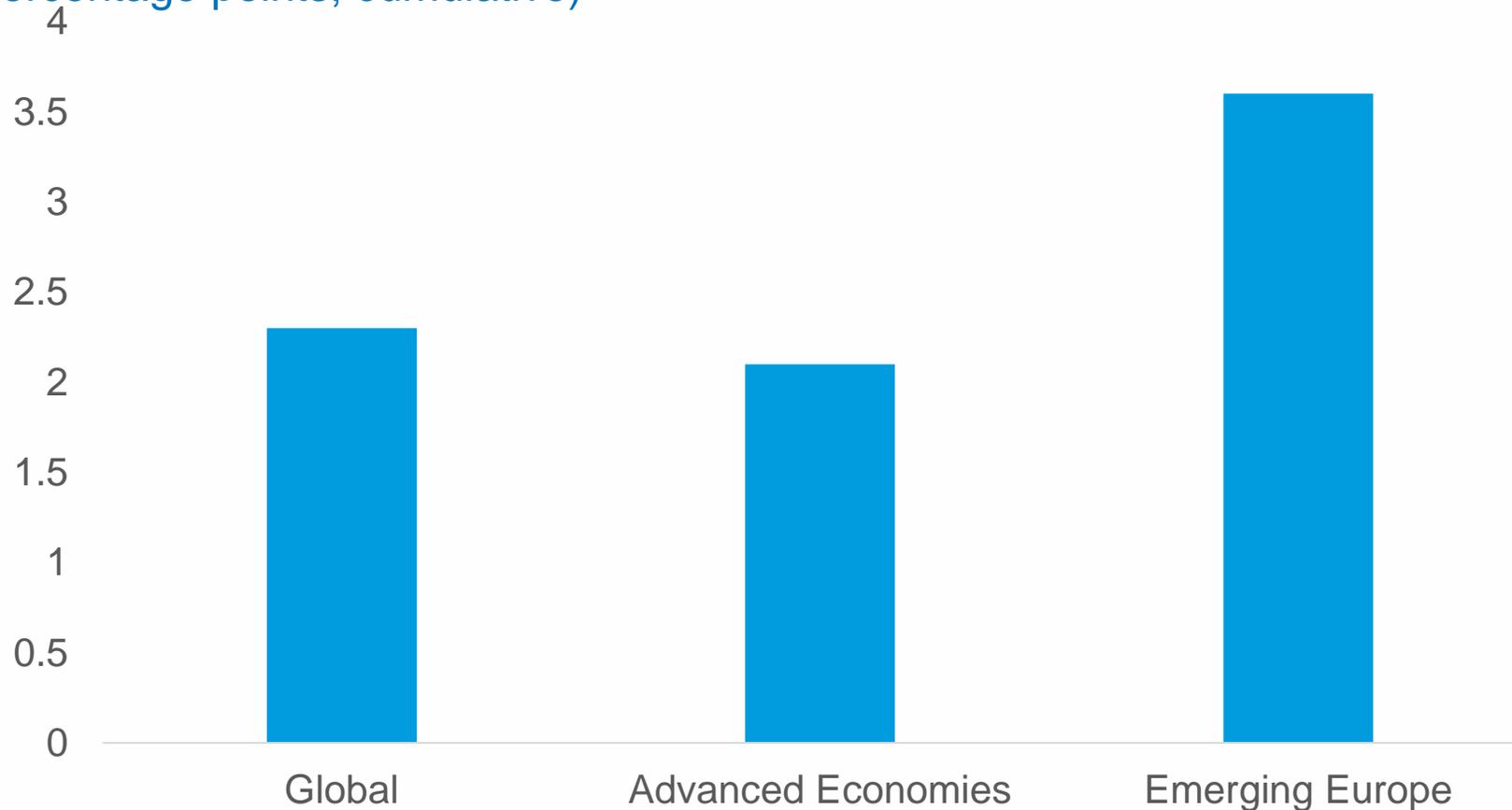


Source: Haver Analytics; Eurostat; and IMF WEO projections.

Fragmentation potentially costly. Maybe inflationary

Permanent Growth cost from Geo economic Fragmentation

(In percentage points; cumulative)



IMF Estimates: scenario assumes barriers on all commodity trade between the US-EU and China; RoW countries trade either exclusively with the US and EU or with China.

Bolhuis, Chen and Kett (2023) Fragmentation in Global Trade: Accounting for Commodities, IMF WP

But offers also an opportunity to grow

CESEE value added in exports (In percent)



Main messages

Soft landing expected, followed by a mild recovery.

Inflation risks are high and fragmentation a lasting disruptive force.

- Do not ease MP too early. Fiscal policy should be more ambitious
- Be prepared that fragmentation could add to inflation and lower growth—
- Take steps to withstand downsides and reap benefits:
 - > Durably attract FDI – governance and transparency can help
 - > Retain strong banks – avoid adding distortions
 - > Strengthen and grow labor force: upskilling employment matching

Thank you